

CIGARETTE TAX  
RCW 82.24

<u>Tax Base</u>	The sale, use, consumption, handling, possession or distribution of cigarettes; the tax applies to the first such taxable event which occurs within the state.
<u>Tax Rate</u>	<p>The combined state tax rate currently totals \$1.425 per package of 20 cigarettes. (The federal government also levies a tax of 39 cents per pack upon cigarette manufacturers.) The \$1.425 state rate is comprised of the following:</p> <ul style="list-style-type: none"><li>- 23 cents. Receipts from this portion of the tax are deposited in the state general fund (RCW 82.24.020(1)).</li><li>- 8 cents. Proceeds are deposited in the water quality account and are used for various water-related programs around the state (RCW 82.24.027). (NOTE: all the proceeds of the 8 cent tax were diverted from the water quality account for FY 2001 and FY 2002: one-half to the violence reduction/drug enforcement account and one-half to a new salmon recovery account.) On July 1, 2021 the receipts are scheduled to be transferred into the general fund.</li><li>- 10.5 cents. Revenues go to the violence reduction and drug enforcement account to fund drug/alcohol programs (RCW 82.24.020(2)).</li><li>- 41 cents. Collections are deposited in the health services account (RCWs 82.24.020(3) and 43.72.900) and used to finance state health care programs.</li><li>- 60 cents. Receipts are deposited in the health services account. However, Initiative 773 requires certain other distributions of these revenues, as described below (Section 3, Initiative 773, adopted November 6, 2001).</li></ul>
<u>Levied by</u>	State
<u>Administration</u>	Department of Revenue. The tax is paid via the purchase of stamps which are affixed to each package of cigarettes by stamping wholesalers. Special licenses are required for sellers of cigarettes; fees for these licenses are paid to the Department of Licensing through the Master Business License application. Wholesalers subject to the cigarette tax are allowed compensation for their costs of affixing the stamps in an amount of \$4.00 per 1,000 stamps (the stamping allowance will increase to \$6.00 on July 1, 2002). Pursuant to 1995 changes in the law, Indian wholesalers/retailers must pre-collect the tax imposed on their customers. Although the

Department of Revenue administers collection of the tax, enforcement activities are performed by the Liquor Control Board.

Recent Collections (\$000)

<u>Fiscal Year</u>	<u>Collections</u>	<u>% Change</u>	<u>% of All State Taxes</u>
2001	\$244,550	(2.2)%	2.1%
2000	250,109	(1.9)	2.1
1999	255,050	(1.5)	2.2
1998	258,870	1.9	2.3
1997	254,060	(0.8)	2.4
1996	256,071	26.8	2.6
1995	201,922	4.1	2.1
1994	193,939	51.0	2.2
1993	128,461	(3.4)	1.5
1992	133,003	3.3	1.7

A breakdown of the FY 2001 cigarette tax collections (\$ in thousands) follows:

General Fund (23cents)	\$ 68,179
Water Quality (8 cents)	- -*
Drug Enforcement (10.5 cents)	42,981
Health Services (41 cents)	121,534
Salmon Recovery	11,856
Total FY 2001 Cigarette Tax	\$244,550

\*Receipts temporarily diverted to salmon recovery account and violence reduction/drug enforcement account for FY 2000-2001.

Distribution of Receipts

Receipts of the cigarette tax are distributed to the various accounts according to the rates as outlined above under the Tax Rates section.

Initiative 773, approved in November, 2001 contains a special distribution for the new 60 cents tax, as well as a reimbursement mechanism for several of the existing accounts. An official interpretation of the special distribution has yet to be made by the Office of Financial Management. However, based on the language in the initiative, the apparent distribution will be made as follows. First, it provides an appropriation of \$5 million in FY 2003 and FY 2004 for health programs that benefit low income persons. Next, the initiative

requires that 10 percent of the remaining funds derived from the 60 cents tax be distributed each year to the tobacco prevention and control account for use in programs that reduce smoking among Washington residents. The remaining receipts of the 60 cent tax, after the reimbursements discussed below, will go to the health services account to be used for supplementing enrollment in the state's basic health plan.

The purpose of reimbursement of the violence reduction/drug enforcement account, the water quality account, and the health services account is to acknowledge that the additional 60 cent tax rate for health services could adversely impact the collections for the other funds, if taxable consumption of cigarettes declines as a result of the increase in overall tax rate. Thus, Initiative 773 specifies that the following dollar amounts shall be transferred from the receipts of the 60 cent tax to these accounts as follows:

Violence Reduction/Drug Enforcement Account:

2001-03 Biennium	\$6,497,500
2003-05 Biennium	\$7,789,000
Subsequent biennia	\$6,932,000

Health Services Account (for the initial 41 cent tax):

2001-03 Biennium	\$26,265,000
2003-05 Biennium	\$31,755,000
Subsequent biennia	\$28,622,000

Water Quality Account:

2001-03 Biennium	\$6,447,000
2003-05 Biennium	\$8,182,000
Subsequent biennia	\$7,885,000

Exemption, Deductions and Credits

- Sales by wholesalers to persons in other states or countries.
- Sales to the federal government.
- Sales to Indians (via allocation program).

History

The cigarette tax was initially imposed as part of the Revenue Act of 1935 at a rate of 1 cent per package. The rate has been increased 17 times over the past 60 plus years. These and other major changes are summarized as follows:

1935 - Cigarette tax imposed at 1 cent per pack.

- 1939 - Rate increased from 1 to 2 cents per pack.
- 1949 - Rate increased from 2 to 4 cents per pack. Receipts from additional 2 cents earmarked for retirement of bonds issued to pay compensation to war veterans.
- 1955 - Additional tax of 0.5 cents per 10 cents of selling price (then roughly equivalent to 1 cent per pack). Receipts dedicated to public school building bond redemption fund until the bonds were retired, then to the general fund.
- 1959 - Rate increased from 5 to 6 cents per pack.
- 1961 - Rate increased from 6 to 7 cents per pack.
- 1965 - Rate increased from 7 to 11 cents per pack.
- 1971 - Rate increased from 11 to 16 cents per pack.
- 1972 - Bonds for veterans bonuses retired; compensation of \$250 extended to Vietnam veterans funded by the 2 cent rate (1949) until 1977 when the compensation was fully paid and the receipts began going to the general fund.
- 1975 - Previous exemption for possession of two cartons of unstamped cigarettes was repealed, thus strengthening cigarette tax enforcement.
- 1981 - Rate increased from 16 to 20 cents per pack.
- 1982 - Two surtaxes increased the rate from 20 cents to 20.8 cents (5/1/82) and to 23 cents (8/1/82).
- 1983 - Surtaxes adopted in 1982 made permanent.
- 1986 - Rate increased from 23 to 31 cents per pack. Receipts from additional 8 cents earmarked for water quality programs. Revisions to the Unfair Cigarette Sales Act; regulation of cost of cigarettes to expire in 1991.
- 1989 - Rate increased from 31 to 34 cents per pack. Receipts from additional 3 cents earmarked for drug education and enforcement programs. The additional three cents rate was scheduled to expire on July 1, 1995.
- 1993 - Rate increase from 34 to 54 cents per pack. Receipts from the additional 20 cent tax earmarked for health programs; legislation includes rate increases for the following three years.
- 1994 - Rate increase from 54 to 56.5 cents per pack due to increase in the health services rate. Expiration of drug enforcement rate repealed and the 7.5 cent rate increase effective in 1995 is approved by both the Legislature and the voters (the only voter-approved tax increase under Initiative 601 to date).
- 1995 - Rate increased from 56.5 to 81.5 cents per pack due to 17.5 cent increase in the health services rate and 7.5 cent increase in the drug enforcement rate. Technical changes in the administration of the tax, including stamping of untaxed cigarettes for Indian consumption, tighter requirements for transporting cigarettes and precollection of the tax in certain situations by Indian wholesalers.
- 1996 - Rate increased from 81.5 to 82.5 cents per pack due to 1 cent increase in the health services rate.
- 1997 - Enforcement of the tax shifted from the Department of Revenue to the Liquor Control Board.
- 1999 - One-half of the 8 cent tax for water quality is diverted to a new salmon recovery account for two years and the remainder of the water quality tax goes to the violence reduction and drug enforcement account for two years.
- 2001 - Legislation was adopted allowing the state to enter into contracts with 16 Indian tribal authorities relating to the imposition of tribal cigarette taxes. The intention

is for a tribe to enact a tax equivalent to the state cigarette tax, thereby providing the tribe with revenues for tribal services and also reduce the incentive for evasion of the state tax.

- 2001 - Cigarette stamping allowance is increased from \$4 to \$6 per 1,000 stamps.
- 2001 - Initiative 773 approved on November 6, 2001. Effective January 1, 2002, this imposes a new cigarette tax of 60 cents per pack, thus increasing the overall cigarette tax rate from 82.5 cents to \$1.425.

### Discussion/Major Issues

In order to administer the exemption for enrolled members of Indian tribes, the Department allows nontaxed (but stamped) sales to recognized tribes in an amount sufficient for the personal use of each tribal member, based on average per capita consumption rates. However, there is concern that some Indians may be purchasing excess quantities of cigarettes directly from suppliers in other states and reselling them to non-Indians through smokeshops located on various Indian reservations.

The \$1.425 cigarette tax rate now levied in Washington is by far the highest in the nation. In second place is New York with a rate of \$1.11 and two states, Alaska and Hawaii, levy a rate of \$1.00 per pack. Four other states have rates between 75 cents and \$1.00 per pack. At the other end of the cigarette tax spectrum, twenty states, principally tobacco-producing southern states, have rates of 25 cents or less. There is concern that Washington's high tax rate will continue to exacerbate the cigarette tax evasion problem, because adjacent states have much lower rates (Oregon, 68 cents; Idaho, 28 cents; Montana, 18 cents; California, 87 cents; and Nevada, 35 cents).

Prior to the 60 cent increase in the tax rate, the Department estimated that evasion of cigarette tax amounts to roughly \$107 million per year (FY 2001) in lost tax revenues, including sales and B&O taxes. Approximately 60 percent of the loss is attributable to purchases at Indian smokeshops by non-Indians. Purchases made in other states represent about 29 percent of the revenue loss and purchases on military reservations for non-military personnel account for an estimated 11 percent of the lost revenue. In addition to the loss of revenue due to tax evasion, the long-term trend in cigarette consumption has been declining in Washington and nationwide. It is too soon to tell what the increase in the tax rate to \$1.425 will do to cigarette tax evasion, but the prospect is not good.

For several years the state worked hard to reach agreement with Indian tribes relating to cigarette taxes, culminating in legislation authorizing contracts adopted in 2001. With the imposition of the new 60 cent cigarette tax rate, there is concern that the aggregate rate of \$1.425 will cause tribal authorities to reexamine their interest in levying such a high tribal tax. Thus, one impact of Initiative 773 could be to undermine the efforts to reach agreement with the tribes and to effectively curtail cigarette tax evasion.

In the past, the cigarette tax has been used to fund bonuses paid to veterans and for retirement of school building bonds. Currently, the receipts are devoted to water quality

improvements, drug programs and health care, in addition to state general fund expenditures. There has been concern by some over the diversity of such programs funded by cigarette tax revenues and the lack of correlation between consumption of tobacco and the problems which these programs address.